

Recent Financial Developments

INVESTMENT, saving, and borrowing have shown little change in the aggregate over the first nine months of this year despite wide swings in components. Among the various investment categories, business fixed asset spending moved up sharply, while inventory investment and residential construction declined. A \$10 billion rise in total private saving was matched by a shift of similar amount from a Government surplus to a deficit on national income and product account.

So far this year, this pattern of stability in aggregate measures and wide swings in components has been evident also in financial flows. As compared with the final quarter of 1963, there were increases in corporate security issues, consumer credit, one-to four-family residential mortgages, and Federal Government borrowing, but reductions in bank lending to business, multifamily residential and commercial mortgages, and State and local security issues.

There was little movement in interest rates over this period: at the end of September both short- and long-term interest rates were little changed from the levels reached at the beginning of the year.

Monetary policy easy

During the first three quarters of 1964, the Federal Reserve continued its stimulative credit policy. It supplied reserves to the banking system by purchasing Treasury securities in quantities adequate to permit a near-record growth in bank credit, without increases in bank borrowing from the Federal Reserve.

The ready availability of reserves encouraged banks to continue to extend credit at a near-record pace (see chart). Loans rose sharply during the second quarter, but as demand eased during the summer quarter, banks rebuilt their holdings of U.S. Government

securities and resumed purchasing tax-exempt securities on a substantial scale.

With a higher portion of credit expansion taking the form of demand deposits this year than in other recent years, a larger volume of Federal Reserve open market purchases was required to maintain an adequate level of bank reserves.

Corporations step up investment

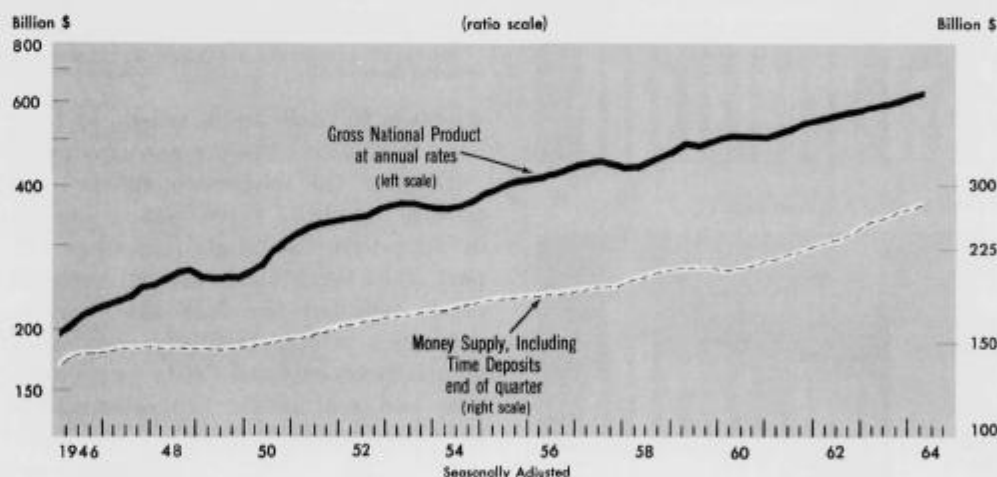
Nonfinancial corporations stepped up their fixed investment by an average

of \$1 billion per quarter during the first nine months of the current year at seasonally adjusted annual rates. This was the fastest rate of increase since the 1956-57 investment boom. The pace of corporate spending quickened in all major industries, but was particularly sharp in manufacturing. Public utility investment spurted, with the rate approaching the previous record set in 1957.

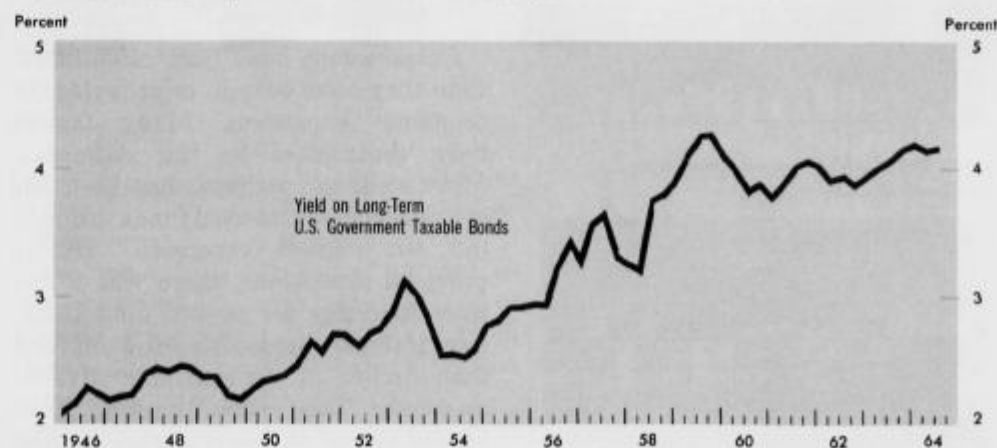
The increase in fixed investment was almost exactly matched by a wide-

Output, Money, and Interest Rates

Since 1960 the money supply has accelerated relative to output . . .



and the rise in long-term interest rates has moderated



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spread decline in the pace of corporate inventory buying. Total corporate purchases of physical assets were thus approximately unchanged over the period under review.

Since the start of the year, the rate of increase in total corporate internal funds was the sharpest recorded during the postwar era except for the initial quarters of recovery from cyclical lows. The cut in corporate taxes was a major factor in this rapid increase but continued growth in business activity also contributed to the advance.

With internal funds expanding and little change in total investment outlays, corporations continued to add substantial

Table 1.—Sources and Uses of Corporate Funds, Annual, 1960–63; Half Years, 1960–64^{1,2}
[Billions of dollars]

	Year				First half ³					Second half ³			
	1960	1961	1962	1963	1960	1961	1962	1963	1964	1960	1961	1962	1963
Sources, total	46.2	52.3	59.2	62.5	23.3	20.3	27.1	29.3	28.3	22.9	32.0	32.1	33.3
Internal sources, total.....	29.1	29.7	35.2	36.8	15.1	14.3	17.6	18.3	20.4	14.0	15.5	17.6	18.7
Retained profits ⁴	6.2	5.6	7.7	8.0	3.8	2.4	4.0	4.0	5.4	2.4	3.2	3.7	4.0
Depreciation.....	22.9	24.1	27.5	28.8	11.3	11.8	13.5	14.2	15.0	11.5	12.3	13.9	14.6
External long-term sources, total.....	9.8	11.8	11.3	10.9	4.6	6.5	5.9	5.2	7.1	5.2	5.3	5.4	5.7
Stocks.....	3.0	4.5	2.1	.6	1.6	2.8	1.4	.5	2.1	1.4	1.7	.6	.1
Bonds.....	5.0	5.1	5.0	5.2	2.0	2.7	2.7	2.5	2.9	3.1	2.4	2.3	2.8
Other debt.....	1.7	2.2	4.2	5.0	1.0	.9	1.7	2.2	2.1	.8	1.3	2.5	2.8
Short-term sources, total.....	7.4	10.8	12.7	14.8	3.6	— .5	3.7	5.8	.8	3.7	11.3	9.1	9.0
Bank loans.....	1.3	.4	3.0	4.3	1.3	— .4	.6	(?)	— 1.7	(?)	.7	2.4	4.3
Trade payables.....	4.5	7.4	5.6	6.8	2.2	.7	1.3	4.6	1.7	2.2	6.7	4.3	2.2
Federal income tax liabilities.....	— 1.6	.7	.9	1.2	— 2.4	— 2.1	— .5	— .8	— 1.0	.8	2.8	1.4	2.0
Other.....	3.2	2.3	3.2	2.5	2.5	1.3	2.2	2.0	1.9	.7	1.1	1.0	.4
Uses, total	43.8	48.8	54.4	58.4	21.7	19.8	25.3	26.2	26.9	22.1	28.9	29.0	32.2
Increase in physical assets, total.....	33.3	30.9	36.4	37.5	18.7	14.5	19.0	18.4	20.7	14.5	16.4	17.4	19.2
Plant and equipment.....	30.8	29.6	32.0	33.8	14.5	13.9	15.1	15.4	18.0	16.1	15.7	16.9	18.4
Inventories (book value).....	2.5	1.3	4.4	3.7	4.1	.6	4.0	2.9	2.7	— 1.6	.7	.5	.8
Increase in financial assets, total.....	10.5	17.8	18.0	20.8	2.9	5.3	6.3	7.8	6.2	7.6	12.5	11.6	13.0
Receivables.....	8.6	9.9	11.3	12.9	4.1	2.9	5.4	6.3	5.3	4.5	7.0	5.9	6.6
Consumer.....	1.8	.1	2.2	2.4	.1	— 2.0	— .3	— .4	— 1.1	1.7	2.1	2.5	2.8
Other.....	6.9	9.8	9.1	10.5	4.1	4.8	5.7	6.7	5.3	2.8	5.0	3.4	3.8
Cash and U.S. Government securities.....	— 1.7	3.6	2.0	2.6	— 3.6	.1	— 2.6	— 2.5	— 2.4	1.9	3.6	4.7	4.5
Cash (including deposits).....	1.0	3.8	1.8	1.7	— 2.0	.2	— 2.4	— 2.6	— 2.0	3.0	3.7	4.2	4.2
U.S. Government securities.....	— 2.6	— .2	.3	.4	— 1.6	— .1	— .3	.1	— .4	— 1.0	— .1	.5	.3
Other assets.....	3.5	4.3	4.7	5.9	2.4	2.4	3.5	4.0	3.3	1.1	2.0	1.1	1.9
Discrepancy (uses less sources)	— 2.4	— 3.5	— 4.9	— 4.1	— 1.6	— .5	— 1.8	— 3.1	— 1.4	— .8	— 3.1	— 3.1	— 1.1

1. Data for 1946–55 may be found in table V–10 of U.S. *Income and Output*, and 1956–59 estimates are in table 34 of July 1962 *Survey*. 2. Excludes banks and insurance companies. 3. Since the data are not adjusted for seasonal variation the first halves of successive years are shown together to facilitate analysis, as are the second halves. 4. Includes depletion. 5. Less than \$50 million.

Sources: U.S. Department of Commerce, Office of Business Economics, based on Securities and Exchange Commission and other financial data.

Bank Credit Easy

With substantial credit available . . .

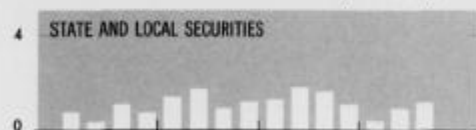
Billion Dollar Change



bank lending has been high . . .



and banks have added to tax-exempt holdings . . .



using their Federal security portfolios to absorb short-term swings



Change From Preceding Quarter
Seasonally Adjusted

Date: FRB

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amounts to their liquid assets, as they have throughout the present expansion.

Despite the improvement in corporate liquidity, there was a stepup in long-term external financing. In part this heightened use of external funds reflected the fact that certain industries which normally rely substantially on external funds—e.g., utilities, and real estate firms—expanded their investment outlays.

Corporations more liquid during current advance

Corporations have been more liquid than they have been in prior periods of economic expansion. Many factors have contributed to this difference. Most striking, perhaps, has been the continued rise in internal funds throughout the current expansion. During previous expansions, there was a distinct tendency for profits—and therefore internal funds—to level off and then decline as the economic advance matured. This time, profits have tended to rise throughout the business expansion. A number of Federal actions affecting taxes during recent years have also tended to raise internal

funds: during 1962, depreciation rules were liberalized and the investment credit instituted; while this year there was a cut in corporate income tax rate.

A lower rate of inventory accumulation also contributed to greater liquidity this time; the increase in inventories has not been enough to keep inventory-sales ratios from falling, in contrast to the rapid buildups which occurred during prior advances. The rise in plant and equipment spending this time has also been somewhat smaller than in earlier business expansions. In the current expansion the better profits position relative to investment requirements has been reflected both in the reduced importance of external long-term financing and in the buildup of corporate liquid assets. In earlier periods, firms stepped up their external long-term financing as the expansion wore on and drew upon previously accumulated liquid assets to finance some of their expanded investment outlays.

Consumer borrowing continues rise

Neither the marked rise in personal saving during the second quarter nor

the return to a more normal saving rate in the third seemed to have any significant effect on consumer borrowing, which continued to rise throughout the period under review. In large part this reflects the fact that much consumer borrowing is associated with the purchase of autos and other big-ticket items, which have moved up this year.

A large part of the increase in borrowing was to finance larger sales of residential housing. Although housing starts declined, purchases of new and existing houses continued to rise, as did extensions of one- to four-family mortgage debt. With only a moderate increase in the volume of debt repayments, record amounts have been added to consumer and mortgage debt this year.

On the whole, individuals continued to add substantially to their holdings of liquid assets during the past three quarters. There was some shift away from time deposits and savings and loan shares toward currency and demand deposits.

There was much evidence of renewed participation by individuals in the stock market: several major stock issues had substantial participation on the part of small investors and there has been a marked increase in mutual fund and odd-lot purchases. Together with heightened institutional activity, this expansion of individual interest has helped to increase stock prices throughout the year. By September, the Standard and Poor index of industrial stock prices stood 13 percent above the level at the opening of 1964.

Government finances

The Federal Government cut taxes quite sharply early this year. As a first result of this stimulative move, the Government's income and product surplus of \$½ billion in the final quarter of 1963 was reduced to a deficit of \$2½ billion in the first quarter of 1964, and fell further to a deficit of about \$8 billion in the second. Rising business activity and a small decline in expenditures brought the deficit to about \$5 billion in the third quarter.

Federal borrowing moved up over this period. However, the rise was much less than would have been needed

to finance the swing in the deficit, had this deficit been fully reflected in the cash position of the Government. The need for borrowing was minimized by the fact that corporation tax payments

were higher than accruals, both because of a speedup in tax payment schedules, and because a substantial volume of taxes were being collected on income taxed at the higher 1963 rates.

Table 2—Sources and Uses of Corporate Funds by Industry, 1957-64
(Billions of dollars)

	Calendar years						Years ended June 30							
	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
Manufacturing and Mining:														
Sources, total.....	18.9	17.9	26.4	19.6	23.8	25.3	14.3	26.0	21.9	18.8	26.7	27.2	28.5	28.6
Retained profits ¹	7.1	4.4	7.5	8.7	6.1	6.1	0.8	4.4	7.2	8.7	4.5	6.1	6.2	8.0
Depreciation.....	9.8	10.2	10.6	11.1	11.7	12.5	14.1	9.9	10.5	10.9	11.3	12.6	12.8	14.4
External long-term sources ²	4.1	2.0	1.4	1.6	2.0	2.4	2.6	3.1	2.3	1.3	2.5	2.1	2.9	1.8
Stocks.....	1.4	(3)	.5	.4	-.3	-.6	-1.0	.4	.4	.3	.4	-.3	-.6	-1.0
Bonds.....	1.8	2.2	.9	.5	2.0	1.6	1.3	1.9	1.4	.4	1.4	1.8	1.0	1.2
Short-term sources ³	-2.3	-4.4	.8	1.2	4.5	3.6	6.1	-2.6	6.0	2.9	.3	5.0	4.8	4.2
Uses, total.....	17.4	14.0	32.5	16.3	22.2	22.9	25.7	11.6	24.8	18.3	16.5	23.2	24.6	25.4
Plant and equipment.....	17.0	12.2	12.0	18.3	14.5	15.6	16.5	16.0	11.0	14.3	14.0	14.9	15.9	17.7
Inventories (book value).....	.8	-2.3	4.4	1.9	1.3	2.0	2.2	-2.7	3.1	3.4	-.8	8.2	2.1	1.0
Receivables and misc. assets.....	.1	2.6	3.9	2.3	6.1	3.1	4.6	(7)	5.2	2.7	2.6	4.8	6.1	4.2
Cash and U.S. Government securities.....	-0.6	1.4	1.3	-2.3	1.3	1.7	2.2	-7.7	4.6	-2.1	-.3	.9	1.4	1.9
Discrepancy (uses less sources).....	-1.2	-3.9	-2.9	-3.3	-1.8	-2.9	-2.8	-2.3	-1.2	-3.5	-2.1	-2.9	-2.7	-3.1
Public Utilities and Communications:														
Sources, total.....	6.2	6.3	8.7	8.3	8.5	9.1	7.9	8.3	8.2	8.4	8.5	8.5	8.4	9.6
Retained profits ¹.....	.2	.3	.5	.7	.5	.8	.8	(7)	.4	.6	.6	.8	.8	.9
Depreciation.....	2.8	3.1	3.3	3.6	3.8	4.2	4.6	2.9	3.2	3.6	3.7	4.0	4.3	4.6
External long-term sources ²	4.3	4.7	3.8	3.6	3.5	3.4	1.9	5.2	3.7	2.6	4.5	3.4	2.9	3.5
Stocks.....	1.0	2.1	1.6	1.0	2.2	.9	.7	1.5	1.8	1.7	2.1	1.0	.8	2.1
Bonds.....	2.8	2.6	2.2	2.6	1.3	2.5	1.2	3.7	1.9	2.9	2.6	2.4	1.7	1.5
Short-term sources ³.....	.3	.3	1.1	.6	.4	.7	.7	.1	1.0	1.1	.2	.4	1.0	.2
Uses, total.....	9.3	9.4	9.9	9.4	9.4	10.1	9.3	9.8	9.1	9.8	10.1	9.1	9.8	11.9
Plant and equipment.....	9.2	8.7	8.3	8.8	8.7	9.1	9.4	9.1	8.6	8.5	8.7	8.9	9.1	10.6
Inventories (book value).....	(7)	-1.1	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Receivables and misc. assets.....	.4	.5	.5	.7	.2	.5	.2	.9	.6	.4	.4	.9	.4	.5
Cash and U.S. Government securities.....	-3.3	.3	.1	-1.1	.6	.6	-.4	.4	.1	(7)	1.0	-.1	.2	.3
Discrepancy (uses less sources).....	1.0	1.2	.2	1.1	.3	1.1	1.4	1.5	.9	.4	1.3	.7	1.4	1.4
Railroads:														
Sources, total.....	.7	.4	.7	.3	.5	.7	1.0	.2	.8	.6	.3	.6	.9	.7
Retained profits ¹	-1.1	-1.1	-1.1	-.2	-.2	-.2	-.2	-.2	-.1	-.2	-.3	-.2	-.2	-.2
Depreciation.....	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0
External long-term sources ²	(7)	-.3	(7)	(7)	(7)	(7)	(7)	-.2	-.2	-.1	-.3	-.3	-.1	-.1
Stocks.....	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Bonds.....	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Short-term sources ³	-1.1	-.3	-.1	(7)	-.2	-.1	.1	-.3	-.2	-.1	(7)	-.1	.1	(7)
Uses, total.....	1.0	.7	1.0	.8	.8	.8	1.4	.5	1.3	1.0	.6	.9	1.1	1.5
Plant and equipment.....	1.4	.8	1.0	1.0	.7	.8	1.1	.7	.7	1.0	.8	.6	.0	1.3
Inventories (book value).....	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Receivables and misc. assets.....	-1.1	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Cash and U.S. Government securities.....	-2.2	(7)	(7)	-.2	.1	.1	-.8	-.5	.5	-.1	-.3	.8	-.3	-.1
Discrepancy (uses less sources).....	.4	.3	.3	.4	.4	.2	.5	.3	.5	.3	.3	.3	.2	.8
Transportation other than rail:														
Sources, total.....	1.5	1.4	2.5	1.7	1.3	1.9	2.5	1.7	2.1	2.3	1.7	1.9	2.3	2.1
Retained profits ¹	(7)	(7)	(7)	-.1	-.1	(7)	.1	(7)	(7)	-.1	-.1	(7)	(7)	.1
Depreciation.....	1.1	1.2	1.3	1.4	1.5	1.7	1.8	1.1	1.2	1.4	1.4	1.6	1.7	1.8
External long-term sources ².....	.3	.5	.6	.8	.3	.1	.3	.5	.5	.4	.4	.1	.2	.3
Stocks.....	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Bonds.....	.3	.4	.6	.3	.3	.1	.3	.4	.4	.4	.4	.1	.2	.3
Short-term sources ³	(7)	(7)	.7	.1	.2	.1	.4	.1	.3	.6	(7)	.3	.3	-.1
Uses, total.....	1.6	1.3	2.3	2.0	2.0	2.0	1.8	1.3	2.0	2.2	2.0	1.9	2.0	2.0
Plant and equipment.....	1.4	1.3	1.8	1.7	1.7	1.8	1.6	1.5	1.4	1.8	1.6	1.8	1.7	1.6
Inventories (book value).....	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Receivables and misc. assets.....	.1	.1	.4	.2	.3	.2	.2	.1	.3	.3	.3	.2	.3	(7)
Cash and U.S. Government securities.....	(7)	-.1	.1	(7)	.1	-.1	(7)	-.2	.3	(7)	.1	-.1	(7)	(7)
Discrepancy (uses less sources).....	.1	-.4	-.3	.3	.1	(7)	-.7	-.4	-.1	-.1	.3	(7)	-.2	-.2

¹ Includes depletion.

² Also includes long-term bank loans, mortgages, and other long-term debt.

³ Less than \$50 million.

⁴ Includes short-term bank loans, trade payables, Federal income tax liabilities, and miscellaneous liabilities.

Source: U.S. Department of Commerce, Office of Business Economics, based on Securities and Exchange Commission, and other financial data.